IN THE

# Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-1490

FEDERAL POWER COMMISSION, *Petitioner,*

v.

TEXACO INC., ET AL., *Respondents.*

No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL., *Petitioners,*

v.

TEXACO INC., ET AL., *Respondents.*

**On Petitions for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

## BRIEF IN OPPOSITION FOR RESPONDENT INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

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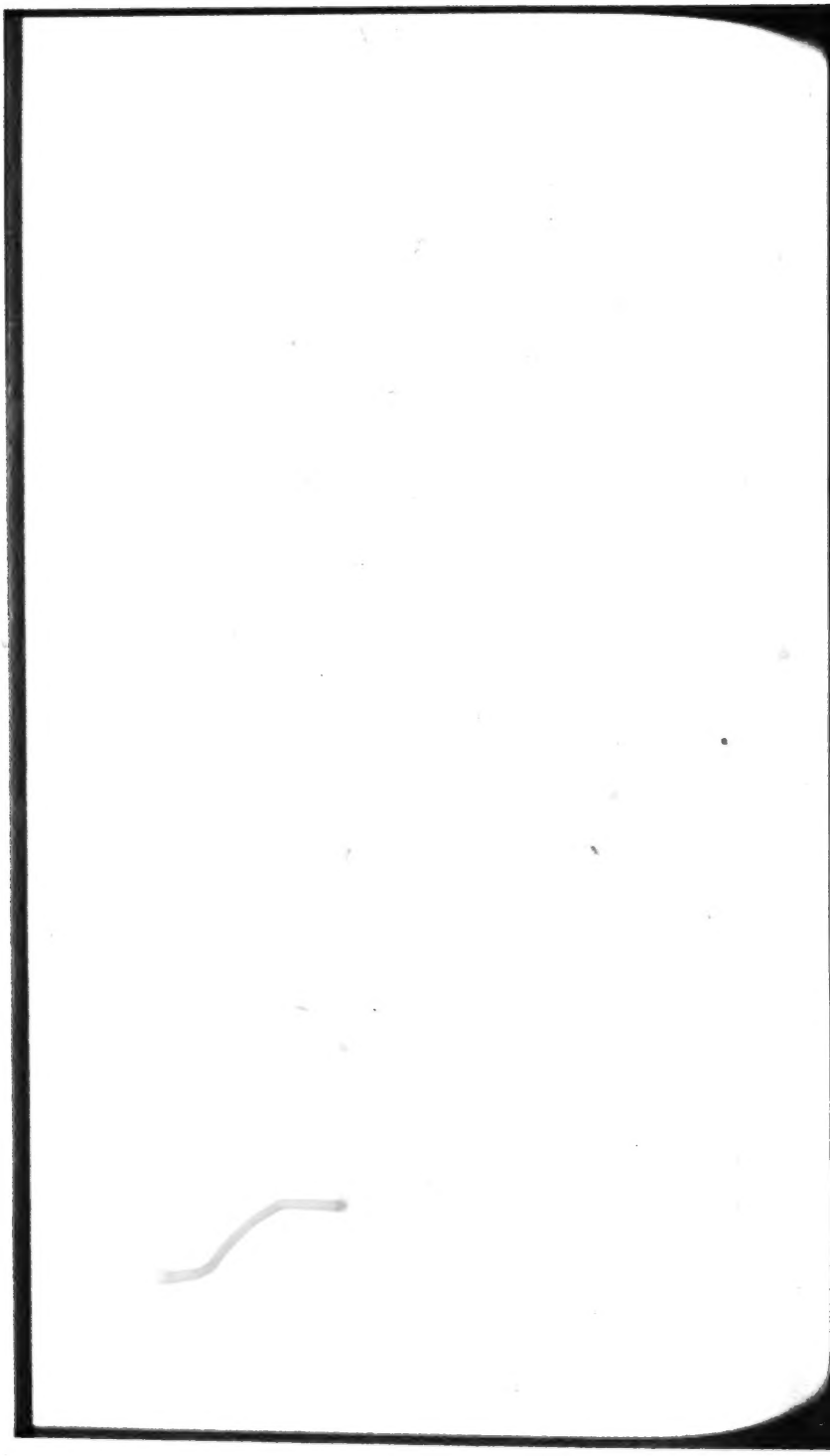

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## BRIEF IN OPPOSITION FOR RESPONDENT INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

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The Independent Natural Gas Association of America (INGAA) is a non-profit trade association representing virtually all of the major long-distance natural gas transmission lines (pipelines) in the

United States.[1] INGAA, a petitioner in the court below, opposes the petitions[2] for writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in the above-described proceedings.

## QUESTION PRESENTED

Does the Federal Power Commission (FPC or Commission) have authority to exempt small producers from direct rate regulation under the Natural Gas Act (Act) by shifting the burden of establishing the justness and reasonableness of rates for interstate wholesale sales of natural gas from the sellers (small producers) to the purchasers (interstate pipelines or large producers)[3] despite clear statutory language to the contrary?

## STATEMENT

### A. Proceedings Before the Commission.

On July 23, 1970, the Federal Power Commission issued, in Docket No. R-393, a Notice of Proposed Rulemaking entitled "Exemption of Small Producers

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[1] INGAA's membership also includes producers and distributors of natural gas.

[2] Reference is made herein solely to the petition of the Federal Power Commission, No. 72-1490, inasmuch as Dougherty, *et al.*, No. 72-1491, do not raise any significant points not already covered by FPC.

[3] Large producers often purchase gas from small producers and subsequently resell the gas to interstate pipeline purchasers. We recognize that large producers may thus be aggrieved in somewhat the same manner as are the interstate pipelines by Order Nos. 428 and 428-B, but in this brief, INGAA will restrict its discussion to the impact of the Commission's unlawful action upon its pipeline company members.

from Regulation" (R. 1-13). In essence, the Commission proposed to exempt small producers[4] from rate regulation under the Natural Gas Act, permitting them to collect contractually-negotiated prices for gas sold in interstate commerce for resale. The Commission undertook to assure small producers that their contract price would not be subject to change by the FPC and, therefore, they would no longer be subject to refund obligations. The Commission's stated purpose was to stimulate additional exploratory efforts and dedication of gas reserves to the interstate market in order to augment the dwindling supplies. Its principal asserted authority for such was its classification powers under Section 16 of the Act.

The Commission did not propose to free small producers from all regulation under the Act, however, announcing that it would retain abandonment authority over small producers' sales pursuant to Section 7(b) of the Act, 15 U.S.C. 717f(b), as well as requiring certain annual reports. Further, the Commission proposed to allow pipelines to file "tracking" rate increases[5] to recover increases in their purchased gas costs which were anticipated as a result of exempting small producers from rate regulation.

After receiving comments from various parties, the Commission issued Order No. 428 entitled, "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief from Detailed

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[4] "Small producers" are those producers selling 10,000,000 Mcf or less of natural gas in interstate commerce for resale annually.

[5] "Tracking" rate increases authorized by the FPC are similar in concept to the more familiar "fuel adjustment" clauses.

Filing Requirements" (FPC Pet., pp. 29a-46a).[6] The Order, in general, followed the proposal indicated by the Commission's Notice of July 23, 1970 with respect to exempting small producers from rate regulation but, for the first time, the Commission indicated that the pipelines' right to "track" increases in purchased gas costs would be limited to that portion of the contract prices paid to small producers which the Commission, in later proceedings, finds justifiable. The essence of the newly-announced *indirect* scheme of small producer rate regulation is set forth in the following excerpts:

> "The action taken here in our view does not constitute deregulation of sales by small producers. We will continue to regulate such sales *but will do so at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producers' sales.*" (Emphasis supplied.) (FPC Pet., p. 32a).
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> * * *
>
> "Any question as to the propriety of the price paid by a pipeline to a small producer *will be subject to review in certificate and rate cases involving that pipeline to make sure it is justified.* The Commission has ample authority to inquire in these cases into the reasonableness of all items of operating expense, including the cost of purchased gas, and to disallow items of cost which are imprudent." (Emphasis supplied.) (FPC Pet., p. 33a).
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> *"Small producers will have no refund obligations* with respect to increased rates . . . However, the pipeline's rates will be subject to reduction and refund, with respect to new small producer sales, but only as to that part of the rate which is unreasonably high considering appropriate comparisons

[6] Reference "FPC Pet." is to the Commission's Petition for Writ of Certiorari in No. 72-1490.

with highest contract prices for sales by large producers or the prevailing market price for intrastate sales in the same producing area." (Emphasis supplied.) (FPC Pet., p. 37a).

INGAA and its pipeline members were, theretofore, unaware that the Commission's proposal for deregulation of small producers raised substantial potential adverse impacts upon the pipelines' ability to recover their legitimate expense items of purchased gas, contracted for in good faith efforts to render adequate service to their customers. INGAA, as did certain of its pipeline members, petitioned for rehearing of Order No. 428 and urged the Commission to correct this situation. On July 15, 1971, the Commission issued Order No. 428-B (FPC Pet., pp. 50a-84a), which modified Order No. 428 in certain respects not at issue herein but reasserted the Commission's authority to engage in the unprecedented scheme of so-called *indirect* small producer rate regulation at the pipeline level.

### B. The Decision Below

The court of appeals, with one judge dissenting, set aside the Commission's action exempting small producers from rate regulation after concluding that such action exceeded the Commission's authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).

The court's decision turned upon an analysis of specific provisions of the Natural Gas Act, namely, Sections 4, 5, 7 and 16 (FPC Pet., pp. 85a-93a). The court concluded, in effect, that the regulation of rates for jurisdictional sales was *mandatory,* and not discretionary or permissive, regardless of the size of the regulated entity. In that connection, the Commission's

Section 16 classification powers do not permit the exemption of small producers from rate regulation under Section 4 of the Act (FPC Pet., pp. 7a-10a). That being the case, the court held that the Commission's Order Nos. 428 and 428-B represented a clear-cut abdication of statutory duty to assure that *all* regulated rates, including those of small producers, be "just and reasonable" (FPC Pet., pp. 10a-16a). This departure from statutory duty and standards through the so-called "indirect" mode of regulation at the pipeline level contravened the provisions of the Natural Gas Act:

> "Nothing at all insures that those levels [of rates allowed to be passed on to consumers] will be 'just' or 'reasonable.' That is the essential flaw in the Commission's plan. That is the point at which the FPC abdicates its regulatory responsibility in derogation of the purposes and mandatory terms of the statute. Indirect 'regulation' by such novel 'standards' is worse than an exemption simpliciter. Such an approach retains the false illusion that a government agency is keeping watch over rates, pursuant to the statute's mandate, when it is in fact doing no such thing." (FPC Pet., pp. 12a-13a).

## REASONS FOR DENYING WRITS

As shown below, the reasons for denying writs are twofold: (1) the decision below is clearly correct, and (2) there is no conflict of decisions to be resolved.

### I

### THE DECISION BELOW IS CLEARLY CORRECT

Although the court below was sympathetic to—in fact, applauded—the Commission's attempts to deal with the critical shortage of natural gas, the court, with

one judge dissenting, nevertheless set aside the Commission's action exempting small producers from rate regulation by shifting the responsibility to the pipeline purchasers. The court concluded that such action exceeded the Commission's authority under the Natural Gas Act (FPC Pet., pp. 3a-22a).

### A. The Provisions of the Act.

The Commission's purported authority for exempting small producers from rate regulation by shifting the burden to the pipeline purchasers stems from Sections 4, 5, 7 and 16 of the Natural Gas Act. The clear and unambiguous language of the Act, however, leaves no doubt that the provisions of Sections 4 and 5 are *mandatory*. They are not permissive or discretionary as the Commission suggests.[7]

Section 4(a) provides:

> "*All* rates and charges made, demanded, or received by any natural gas company . . . shall be just and reasonable, and *any* such rate or charge that is not just and reasonable is hereby declared to be unlawful." (Emphasis supplied.)

Section 4(b) provides:

> "*No* natural gas company shall with respect to *any* transportation or *sale* of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person . . . or (2) maintain any unreasonable differ-

[7] The Commission in issuing Order No. 428 said: "We disagree with the argument that the provisions of Sections 4, 5 and 7 of the Act, which speak in terms of all sales in interstate commerce for resale by any natural gas company, are mandatory and leave no room for administrative judgment and discretion." (FPC Pet., pp. 30a-31a).

ence in rates, charges . . . between classes of service." (Emphasis supplied.)

Section 4(c) provides that:

"... *every* natural-gas company *shall file* with the Commission . . . *schedules showing all rates* and charges *for any* transportation or *sale* subject to the jurisdiction of the Commission . . .". (Emphasis supplied.)

Section 5 is likewise clear. It provides that:

"(a) Whenever the Commission, after hearing... shall find that *any* rate . . . charged, or collected by *any* natural-gas company . . . is unjust, unreasonable, unduly discriminatory, or preferential, the Commission *shall* determine the just and reasonable rate . . . to be thereafter observed and in force and shall fix the same by order . . .". (Emphasis supplied.)

It is not surprising, therefore, that the court below found, after reviewing the above provisions, that they are *mandatory* and are applicable to *all* wholesale sales of natural gas in interstate commerce by producers irrespective of their size (FPC Pet., pp. 7a, 8a). A review of Sections 4 and 5, considered apart from Section 16, can lead to no other conclusion. Indeed, the Commission does not contend otherwise. To the contrary, the Commission asserts that its authority to exempt small producers from rate regulation by shifting its responsibility to the pipeline purchasers stems from its classification powers under Section 16 of the Natural Gas Act.

As the court of appeals held, the regulatory mandate of Sections 4 and 5 of the Act is in no way circumscribed or diminished by Section 16 classification powers which are designed for administrative con-

venience, and *not* as a device for expanding, contracting or otherwise changing the coverage of the Act:

> "Thus the Commission's power, under Section 16 of the Natural Gas Act, to 'classify persons and matters within its jurisdiction' and to 'prescribe different requirements for different classes' cannot validate this exemption of small producers. The Commission can only classify '[f]or the purposes of its rules and regulations.' It can only prescribe rules and regulations 'to carry out the provisions of this chapter.' Section 16 thus does not give the Commission independent powers. Rather, it provides for implementation of the core sections of the Act, such as Section 4." (FPC Pet., pp. 9a, 10a).

The court of appeals correctly concluded that only Congress could effectuate the change in the regulatory scheme sought by the Commission:

> "Only Congress can knowingly prescribe nonregulation for small producers in lieu of the existing statutory scheme of regulation found by the Supreme Court in *Phillips* [*Phillips Petroleum Co.* v. *Wisconsin,* 347, U.S. 672 (1954)] to be mandatory under the Natural Gas Act for all producers." (FPC Pet., p. 16a; see also p. 17a, fn. 25).[8]

In relying on Section 16 for authority to shift the rate regulatory responsibility from small producers to the pipeline purchasers, the Commission cites its need for flexibility "to make pragmatic adjustments which

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[8] For pending legislative proposals affecting producer regulation under the Natural Gas Act, see S. 371, S. 1162, S. 1549, H.R. 480, H.R. 2533, H.R. 2866, H.R. 3299, H.R. 3566, H.R. 3685, and H.R. 7507, all 93rd Congress, 1st Session.

may be called for by particular circumstances."[9] The court below has correctly noted, however, that such latitude of regulatory agencies is restricted by "the ambit of their statutory authority." In short, there is no authority within the four corners of the pertinent provisions of the Natural Gas Act which justifies or validates the shift of rate regulatory responsibility as proposed by the Commission.

### B. Past Commission Actions Confirm the Lack of Statutory Authority.

It is of significance to note that, in the early days of producer regulation, the Commission's interpretation of its powers under the Natural Gas Act comports with the decision of the court below.

Shortly after the *Phillips* decision, and before the institution of area rate proceedings, the Commission acted to simplify the filings by small producers, relying upon its authority to prescribe different procedures for different classes of regulated companies under Section 16 of the Act, 15 U.S.C. 717o (FPC Pet., pp. 92a, 93a). Nevertheless, in so doing, the Commission recognized that the coverage of the Act was *mandatory*, and it stated in Order No. 174-B, 13 FPC 1576, 1577 (1954):

> "5. Some of the petitions urged that the regulations be amended to relieve small producers from

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[9] *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942); see also, *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 642 (1972):

> "FPC and other agencies created to protect the public interest must be free, '*within the ambit of their statutory authority*, to make the pragmatic adjustments which may be called for by particular circumstances' [citing *Natural Gas Pipeline*]." (Emphasis supplied.)

the requirements of the statute. *The Act does not provide for exemptions from its requirements,* but the regulations for producers are herein revised in Sections 154.91, 154.92, 154.94 and 157.23 to further simplify the filings by small producers." (Emphasis supplied.)

Judicial recognition to the same effect is *Saturn Oil and Gas Company* v. *FPC,* 250 F.2d 61 (10th Cir. 1957), *cert. denied* 355 U.S. 956 (1958), wherein the Tenth Circuit stated:

> *"There is nothing in the Natural Gas Act which makes its applicability depend on the size* or the integration *of the gas operator.* The Phillips decision holds that the Act applies to *all* wholesales by producers. Saturn may not escape regulation because of its size or because of the restricted nature of its operations." (Emphasis supplied.) 250 F.2d at 66-67.

Thus, the past history of producer regulation fully confirms and underscores the correctness of the decision of the court below that Section 16 does not provide authority for the Commission's actions herein.

### C. The Permian and Hunt Cases Do Not Support the Commission.

The Commission has attempted to construe this Court's decisions in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968) and *FPC* v. *Hunt,* 376 U.S. 515 (1964) as supportive of its attempt to shift rate responsibility from small producers to pipelines. The Commission's reliance on these decisions is misplaced.

In its first area rate proceeding, the Commission provided for special treatment for small producers by exempting them from certain filing requirements under Sections 4 and 7 of the Act. 34 F.P.C. 159, 234, 235

(1965). On review, this Court held in *Permian* that the Commission's separate classification of small producers pursuant to Section 16 powers was consistent with its statutory responsibilities. 390 U.S. at 787. However, as the court of appeals noted, the small producers in *Permian* were expressly limited to the "just and reasonable" area rate determined by the Commission under Sections 4 and 5 of the Act. The court below said:

> ". . . the Commission is saying that the whole issue in the lawsuit is no different from *Permian*. That just isn't so. The absence of such a 'just and reasonable' limit *is* the big difference. Order No. 428 not only allows small producers to exceed the reasonable and just area rate ceilings—it allows them to do so on the basis of the free market, which is the antithesis of regulation." (Emphasis in original.) (FPC Pet., p. 11a, fn. 18).

Likewise, the Commission's reliance on *dicta* in *Hunt* suggesting that the Commission study NLRB exemption procedures was shown by the court of appeals to be inapposite; simply put, the Natural Gas Act, unlike the National Labor Relations Act,[10] does not give the FPC discretion to decline to exercise its jurisdiction over the seller of natural gas by purporting to regulate producer rates at the pipeline-purchaser level.

### D. The Commission's Theory of "Indirect" Regulation Is Invalid.

The Commission attempts to justify its action as "indirect" regulation of small producer rates. However, the Commission's assertion that it has not ex-

[10] 29 U.S.C. 160(a).

empted small producers' sales from *substantive* requirements of the Act (FPC Pet., p. 11) is totally at odds with reality; no amount of strained semantics can conceal the fact that small producers have, indeed, been relieved of the statutory "just and reasonable" standard with respect to their rates.[11]

With respect to the concept of "indirect" regulation, the court below took the Commission to task, pointing out that regulation and nonregulation are essentially different concepts, and that:

> "It strains credulity to assert that the Commission meant to achieve just and reasonable rates through normal market forces, while in the very same Orders it refused to let pipelines and large producer plant operators pass on these 'just and reasonable' rates without further review under new non-statutory standards. Since the Commission itself has not been confident enough to conclude that the market will necessarily yield rates that comply with the statute, this court can hardly uphold the Orders on that ground." (FPC Pet., p. 14a).

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[11] The Commission's attempt to shift the burden of small producer rate regulation to an "indirect" review of pipelines' justification of the contractually-negotiated prices paid to small producers represents a remarkable departure from prior practice. Before the effective date of the Commission's Orders exempting small producers from rate regulation, the affected producers either had rates on file with the Commission or were subject to area rate ceilings prescribed by the Commission. These rates were the only rates which the purchasing pipelines could legally pay for the purchased gas; having paid the filed or fixed rates, these purchased gas expenses could not be questioned in subsequent pipeline proceedings as to the propriety thereof. See generally, *Montana-Dakota Utilities Co.* v. *Northwestern Public Service Co.*, 341 U.S. 246 (1951), and *Jupiter Corporation* v. *FPC*, 424 F.2d 783, 788 (D.C. Cir. 1969).

On this point, the Commission seeks solace in a footnote reference by the Fifth Circuit in its recent *Placid Oil Co.* v. *FPC* decision (No. 71-2761, decided April 16, 1973) to the effect that regulated rates *may* get closer and closer to a basis of existing market conditions. Of course, the Fifth Circuit was speaking of a regulated rate determined by the Commission as "just and reasonable," an essential distinction not present here. If the rates of small producers were based upon existing market conditions and were validly determined by the Commission to be "just and reasonable," the pipelines would have no complaint since, under such circumstances, they (the pipelines) would be assured that the *full* cost could be included in their rates. In sharp contrast, the Commission issued Order No. 428 without such a finding by granting blanket authorization to all small producers to charge whatever they were able to negotiate with the pipeline purchasers.

The Commission also seeks to support its action as experimental in nature. The court below, while sympathetic to the Commission's problems in coping with the shortage of natural gas and having, itself, approved "experiments" on that basis in the past,[12] could not condone the Commission's proposed "indirect" regulation, which it characterized as an experiment in "*non*regulation" (FPC Pet., p. 17a).

The Commission's belated reliance on Section 5 powers is, we submit, self-defeating. This *post hoc* rationalization, which we see for the first time in the Commission's petition for certiorari (FPC Pet., p.

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[12] FPC Pet., p. 7a, fn. 7.

12), is wholly at odds with the previously stated iron-clad assurance that small producers' contract prices would *not* be subject to reduction and refund (see page 4, *supra*). To *now* add the possibility of a reduction in the rates of small producers under the powers of Section 5(a) of the Act will only compound the regulatory uncertainty and risk and will be, obviously, counter-productive to the Commission's entire rationale underlying the proposal involved in the instant rulemaking.

Finally, this Court has previously rejected the Commission's theory of "indirect regulation" of producers under the Natural Gas Act. As far back as 1951, the Commission rendered a decision in which it ruled that Phillips Petroleum Company was not a "natural-gas company" within the meaning of the Natural Gas Act (10 F.P.C. 246 (1951)). In partial justification of its interpretation of the Act, the Commission stated:

> "Likewise, in the exercise of its power to regulate the wholesale rates charged by interstate pipeline companies, this Commission has ample authority to inquire into the reasonableness of all items of operating expense—including the cost of purchased gas—and to disallow, for purposes of rate-making, items of cost which are collusive or otherwise improperly excessive." (*Id.* at 280).[13]

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[13] *Contra, Texas Eastern Transmission Corporation, et al.*, 29 F.P.C. 249 (1963), *aff'd sub nom. United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965), where the Commission stated the better view (at p. 256): "Control limited to approving the costs of gas to the purchasing pipeline is, of course, not an effective way to regulate producer prices because in the large *a pipeline must be allowed to pass on its purchased gas costs to the ultimate consumer or it cannot continue to discharge its public service responsibilities.*" (Emphasis supplied.)

Subsequently this Court, in its landmark decision in *Phillips, supra,* flatly rejected the Commission's interpretation of the Act and held:

> ". . . we believe that the legislative history indicates a congressional intent to give the Commission jurisdiction over the rates of *all* wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company." (Emphasis supplied and footnote omitted.) 347 U.S. at 682.

## II

## THERE IS NO CONFLICT OF DECISIONS

The Commission argues (FPC Pet., pp. 12, 13) that the decision below is contrary to this Court's decision in *Permian, supra,* which held open the possibility that the "records in subsequent area rate cases might more clearly establish that the market mechanism will adequately protect consumer interests." 390 U.S. at 795. Such an argument is premised on an overstatement of the court of appeals' discussion of this question. The decision below does not foreclose the possibility that the "records in subsequent area rate cases" might justify reliance upon market forces in the regulation of producer prices and, accordingly, does not conflict with *Permian* (FPC Pet., p. 12a, fn. 20). In this connection, the court refers, with seeming approval, to the Commission's recently issued rulemaking Order Nos. 455 and 455-A (FPC Pet., p. 13a, fn. 21) which establish an "optional certification procedure" for new gas sales.[14] And, like the matter here-

[14] Order Nos. 455 and 455-A are pending judicial review in the D. C. Circuit, *Moss* v. *FPC* [No. 72-1837] and *APGA* v. *FPC* [No. 72-1846].

in, these orders seek to assure producers—without regard to their size—of receipt of their certified contract prices throughout the contract term. Thus, as to new gas, Order Nos. 455 and 455-A would do for *all* producers, large and small, what the Commission was attempting to do for only small producers in Order Nos. 428 and 428-B, i.e., give the certainty of contract rates. The one significant distinction, however, is the requirement, under the optional certificate procedure, that the contract be first submitted to the Commission in order that the pricing provisions may receive approval as "just and reasonable."

## CONCLUSION

The petitions for writ of certiorari should be denied.

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